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May 9, 1994

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: CC Docket No. 94-1; Price Cap Performance Review for Local Exchange Carriers

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's comments in the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Elizabeth Dickerson

Elizabeth Dickerson
Manager, Federal Regulatory

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Before the
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In the Matter of	)	
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Price Cap Performance	)	
Review for Local	)	CC Docket No. 94-1
Exchange Carriers	)	

COMMENTS OF

MCI TELECOMMUNICATIONS CORPORATION

Elizabeth Dickerson
Manager, Federal Regulatory
1801 Pennsylvania Avenue, NW
Washington, DC 20006
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May 9, 1994

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SUMMARY

MCI Telecommunications Corporation ("MCI"), the second-largest user of interstate access services purchased from the local exchange carriers ("LECs"), supports the continued use of price cap regulation to constrain interstate access rates, but only to the extent that ratepayers receive their fair share of the benefits that incentive regulation is capable of producing. The existing price cap regulatory plan has revealed itself to be an overly-conservative "first step" by a regulatory agency apprehensive that more aggressive constraints on LEC pricing might cause the new regulatory structure to implode. Those concerns have long since evaporated. In fact, the LECs operating under price cap regulation have reaped earnings far in excess of their brethren who remain governed by rate of return regulation. Meanwhile, those who made this financial success possible -- the ratepayers -- watched as LECs decreased interstate access rates only to the bare minimum extent to comply with the regulation. Further, they witnessed the LECs manipulating their sharing obligations by declaring large expenses in the fourth quarter of each year. All of this occurred in an environment in which the LECs' actual cost of capital dropped far below the level embedded in the price cap plan in 1990.

The Commission must revise the key parameters of the plan with the goal of achieving a more equitable allocation of benefits between LEC ratepayers and LEC shareholders. As described and explained in detail below, and supported by the historical and financial record, MCI urges the Commission to raise the baseline

productivity factor to 5.9%. In addition, MCI argues that the common line price cap index be revised to give interexchange carriers ("IXCs") the full benefits of growth in interstate demand. Also, the Commission should retain sharing requirements and adjust the boundaries downward, to reflect a contemporary cost of capital of 9.54%. The Commission should abandon the low-end adjustment mechanism, since the plan is already well-equipped with safety nets for LECs who might be unable to meet the productivity benchmark. Further, exogenous cost theory and practice also require reform, to ensure that the LECs do not erode productivity incentives and administrative savings by continually seeking new exogenous changes to raise their price cap index levels. Finally, MCI recommends modifications on a number of other baseline issues, and it offers comment on other transitional issues, as well.

Today, in the fourth year of LEC price cap regulation, LEC interstate access rates remain unreasonably far above cost. In addition, the average price cap company that enrolled in the plan from the beginning is now earning 1.6% over the limit at which rate of return companies' earnings are capped. Individual LECs reported 1993 earnings as high as 15.8% (Centel and Contel), 14.99% (Lincoln), 14.7% (Ameritech), 13.9% (Bell Atlantic), and 13.7% (BellSouth).

These earnings levels are all the more outrageous when compared to a more contemporary cost of capital calculation that reflects financial conditions that generally prevailed during the three year period under review, and that exist today. At 9.54%, this current cost of capital is almost 75 basis points below the low-end adjustment mechanism that entitles price cap carriers to increase rates to target a return of 10.25%.

Ratepayers have fared less well under the current price cap plan. Few LECs have stepped up to the more robust 4.3% productivity offset that promised to increase the pace of LEC access reductions. In general, those who did backed away from the challenge in the following access year. LECs also have engaged ratepayers in drawn-out disputes over exogenous cost increases that would significantly increase LEC rates and pricing flexibility. Perhaps most significantly, for the last three years, shareholder benefits from the plan have eclipsed ratepayer benefits by $900 million. Unless prompt corrective action is taken in this review, that amount will grow to well over $1 billion next year.

This skewed result, with shareholders receiving substantially more benefits than ratepayers, occurred because the 1990 Commission selected certain key parameters that virtually assured LECs of unjustified increased earnings. For example, the Commission inflated its cost of capital finding upward specifically to give LECs additional earning power in response to LEC promises they would "reinvest" in infrastructure. Also, in selecting the baseline productivity offset, the 1990 Commission relied on a version of its short term productivity study that included an extremely controversial data point, thereby reducing the historical measure of productivity. In turn, this decision contributed to the selection of an even lower number for the actual offset, since the Commission decided to "balance" the results of the short term study with a long term study evaluating the price performance of the pre-divesture AT&T. These and other pivotal decisions in the price cap plan turned this "incentive" regulation package into a no-lose proposition for the LECs in the 1991-1994 period. This Commission now has an opportunity to correct the imbalance and more equitably distribute the benefits of a price cap plan.

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COMMENTS

INTRODUCTION

MCI, the second-largest user of interstate access services purchased from the LECs supports the continued use of price cap regulation to constrain interstate access rates, but only to the extent that ratepayers receive their fair share of the benefits that incentive regulation is capable of producing. In a market and regulatory environment in which IXCs such as MCI have extremely limited opportunities to purchase access services from competing sources, regulation must ensure that rates are just and reasonable. The existing price cap regulatory plan was a radical departure in interstate ratemaking at the time of its adoption, and it has subsequently revealed itself to be an overly-conservative "first step" by a regulatory agency apprehensive that more aggressive constraints on LEC pricing might cause the new regulatory structure to implode. Those concerns have long since evaporated. In fact, the LECs operating under price cap regulation have reaped earnings far in excess of their brethren who remain governed by rate of return regulation. Meanwhile, those who made this financial success possible --

the ratepayers -- watched as LECs decreased interstate access rates only to the bare minimum necessary to comply with the regulation. Further, they witnessed the LECs manipulating their sharing obligations by declaring large expenses in the fourth quarter of each year. All of this occurred in an environment in which the LECs' actual cost of capital dropped far below the level embedded in the price cap plan in 1990.

In response to the Commission's Notice of Proposed Rulemaking to review the LEC price cap plan[1], MCI submits its comments requesting modifications of numerous aspects of the existing plan. MCI does not argue in these comments that the price cap plan requires fundamental revision. Those arguments were raised and resolved in the 1990 decision, on reconsideration, and in the subsequent court appeal.[2] MCI does argue that the Commission must revise the key parameters of the plan with the goal of achieving a more equitable allocation of benefits between LEC ratepayers and LEC shareholders.

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[1]Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 94-10, released February 16, 1994 ("Notice").

[2] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 887-313, 5 FCC Rcd 6786 (1990) ("LEC Price Cap Order"), Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990), modified on recon., 6 FCC Rcd 2637 (1991) ("LEC Reconsideration Order"), aff'd, National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993). The new services test was resolved in Amendment of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Dockets No. 89-79 and 87-313, 6 FCC Rcd 4524 (1991) ("Part 69 ONA Order"), recon. 7 FCC Rcd 5235 (1992), petitions for further recon. on other issues pending.

Today, in the fourth year of LEC price cap regulation, LEC interstate access rates remain unreasonably far above cost.[3] In addition, the average price cap company that enrolled in the plan from the beginning is now earning 1.6% over the limit at which rate of return companies' earnings are capped. This average tells only part of the story. Based on 1993 earnings data filed with the 1994 Annual Access filings, only one LEC -- GTE -- earned below the 11.25% "midpoint" of the earnings zone, and only two -- GTE and SNET -- earned below the 12.25% level where earnings first become subject to sharing requirements. Other LECs reported 1993 earnings as high as 15.8% (Centel and Contel), 14.99% (Lincoln), 14.7% (Ameritech), 13.9% (Bell Atlantic), and 13.7% (BellSouth).

These earnings levels are all the more outrageous when compared to a more contemporary cost of capital calculation that reflects financial conditions that generally prevailed during the three year period under review, and that exist today. As explained in greater detail in these comments, the "midpoint" of the price cap earnings zone must be recalibrated from 11.25% to 9.54% to reflect current financial markets. At 9.54%, the new midpoint is almost 75 basis points below the low-end adjustment mechanism that entitles price cap carriers to increase rates to recoup of return of 10.25%.

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[3] The LECs themselves agree that interstate access rates are too high. See, e.g., NYNEX Universal Service Protection Plan, Petition for Waiver, filed December 15, 1993 (reducing the switched interstate access per minute rate from 3.9 cents per minute to 2 cents per minute, while imposing new bulk-billing charges on interexchange customers), Public Notice, Pleading Cycle Established for Comments on NYNEX's Petition for Waiver of Parts 61 and 69, 9 FCC Rcd 139 (Com. Car. Bur. 1993).

Ratepayers have fared less well. Few LECs have stepped up to the more robust 4.3% productivity offset that promised to increase the pace of LEC access reductions.[4] In general, those who did backed away from the challenge in the following access year. LECs also have engaged ratepayers in drawn-out disputes over exogenous cost increases that would significantly increase LEC rates and pricing flexibility. Their efforts resulted in Commission tentative acquiescence in an industry-wide price cap increase of $190 million, subject to an investigation,[5] effectively insulating LEC rates from downward adjustments despite the price cap formula's subsequent indication that LEC costs should be declining. In the most recent annual access filing, for example, numerous price cap LECs did not propose rate reductions equivalent to the Commission-mandated exogenous cost decreases. Perhaps most significantly, for the last three years, shareholder benefits from the plan have eclipsed ratepayer benefits by $900 million. Unless prompt corrective action is taken in this review, that amount will grow to well over $1 billion next year.[6]

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[4] In 1991, only one carrier elected the higher 4.3% productivity offset. In 1992, four carriers made that election; and in 1993, six carriers. In 1994, seventeen carriers elected the higher hurdle, of fourteen of which were United/Centel companies.

[5] Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions," CC Docket No. 92-101, 8 FCC Rcd 1024 (1993) ("OPEBs Order"). A lesser amount of exogenous costs were allowed to take effect, subject to investigation, in 1993 Annual Access Filings, CC Docket No. 93-193, 8 FCC Rcd 4960 (Com. Car. Bur. 1993) ("1993 Annual Access Order").

[6] See infra, Baseline Issue 3a, for an explanation of this number.

This skewed result, with shareholders receiving substantially more benefits than ratepayers, occurred because the 1990 Commission selected certain key parameters that virtually assured LECs of unjustified increased earnings. For example, the Commission inflated its cost of capital finding upward specifically to give LECs additional earning power in response to LEC promises they would "reinvest" in infrastructure. Also, in selecting the baseline productivity offset, the 1990 Commission relied on a version of its short term productivity study that included an extremely controversial data point, thereby reducing the historical measure of productivity. In turn, this decision contributed to the selection of an even lower number for the actual offset, since the Commission decided to "balance" the results of the short term study with a long term study evaluating the price performance of the pre-divesture AT&T. These and other pivotal decisions in the price cap plan turned this "incentive" regulation package into a no-lose proposition for the LECs in the 1991-1994 period. This Commission now has an opportunity to correct the imbalance and more equitably distribute the benefits of a price cap plan.

Fortunately for ratepayers, however, the Commission has moved beyond price cap regulation in the last few years, embracing pro-competitive policies that over time and with further development potentially could result in an effectively competitive market. Such a market would feature reasonable LEC rates, innovative LEC services, and high quality and technologically advanced LEC networks. As ratepayers already have seen, the meekest threat of competition for LEC DS1 and

DS3 special access offerings sparked the introduction of a slight movement toward cost-based prices in the form of discounted term plans, fiber rings, and some overall price reductions. The Commission should feel confident that its pursuit of an effective competitive environment is the best policy to ensure just, reasonable, and nondiscriminatory access rates.

Until an effectively competitive environment emerges, however, regulation is the only effective way to achieve those results. MCI contends that in order for the price cap plan to confer reasonable rates, and for the plan to live up to the goals the Commission identified for it, the Commission must modify the price cap plan to capture a more equitable share of benefits for ratepayers by moving access prices closer to cost. As described and explained in detail below, and supported by the historical and financial record, MCI urges the Commission to raise the baseline productivity factor to 5.9%. In addition, MCI argues that the common line price cap index be revised to give IXCs the full benefits of growth in interstate demand. Also, the Commission should retain sharing requirements and adjust the boundaries downward, to reflect a contemporary cost of capital of 9.54%. The Commission should abandon the low-end adjustment mechanism, since the plan is already well-equipped with safety nets for LECs who might be unable to meet the productivity benchmark. Further, exogenous cost theory and practice also demand reform, to ensure that the LECs do not erode productivity incentives and administrative savings by continually seeking new exogenous changes to raise their price cap index levels. Finally, MCI recommends modifications on a number of other baseline issues, and it offers comment on other transitional issues, as well.

GENERAL ISSUE 1

Whether and how the Commission should revise the goals of the LEC price cap plan so that the plan may better achieve the purposes of the Communications Act and the public interest.

In the original price cap proceeding, the Commission articulated the goals upon which it based its decision to adopt price cap regulation for LECs: (1) to reverse the perverse incentives of rate of return regulation that increase costs and reduce the efficiency of regulated entities; (2) to create positive incentives for innovation; (3) to minimize regulatory reliance on cost allocation to guard against unlawful cross-subsidization; and (4) to alleviate administrative burdens associated with regulation.[7] The Commission recognized that to achieve these goals it should "harness the profit incentive to reward companies that become more productive and efficient, while ensuring that productivity and efficiency gains are shared with ratepayers."[8] While MCI believes that these goals continue to be valid, it urges the

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[7] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 2907-13, 2922-33 (1989) ("AT&T Price Cap Order"), modified on recon., 6 FCC Rcd 665 (1990) ("AT&T Price Cap Reconsideration Order"), remanded on other grounds, AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992). An unrelated portion of the AT&T Price Cap Order was vacated in response to the remand in Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order and Notice of Proposed Rulemaking, 8 FCC Rcd 3715 (1993).

[8] LEC Price Cap Order, 5 FCC Rcd at 6787.

Commission to consider also adopting the goal of promoting the development of competition in the interstate access market.

When the Commission originally adopted the LEC price cap plan, it had not yet formally authorized competition for interstate access services. Indeed, the Commission had not yet taken any ground-breaking public policy actions that would foster competition in the interstate access market.[9] Today, the Commission has authorized competition for special and switched transport services, and it is evaluating other proposals that would assist in the transition to a fully competitive interstate access environment.[10] In light of these developments, any regulatory program that affects the LECs' abilities to set prices for their services should be consistent with the objective of encouraging competition for interstate access services.

As the evolution of competition in the long distance and customer premise equipment markets has shown, innovation, high quality services, and reduced

[9] Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992) ("Expanded Interconnection Order"), modified on recon., 8 FCC Rcd 127 (1992), modified on second recon., 8 FCC Rcd 7341 (1993), petitions for recon. pending, appeal pending sub nom. Bell Atlantic Corp. v. FCC, No. 92-1619 (D.C. Cir., filed Nov. 25, 1992); see also, CC Docket No. 91-141, Second Report and Order, 8 FCC Rcd 7374 (1993); see also, Transport Rate Structure and Pricing, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992), petition for recon. pending, modified on recon., 8 FCC Rcd 5370 (1993), modified on second recon., 8 FCC Rcd 6233 (1993), petitions for recon. pending, appeal dismissed sub nom. New England Tel. and Tel. Corp. v. FCC, No. 93-1670 (D.C. Cir., filed Oct. 1993).

[10] See, e.g., MFS Communications Company, Inc., Petition for a Notice of Inquiry and En Banc Hearing, RM-8388, filed November 1, 1993; and Ad Hoc Telecommunications Users Committee, Petition for Rulemaking, filed April 1994.

rates are the ultimate benefits that consumers realize from competition. To achieve benefits in the access service markets similar to those accomplished in the long distance market, the Commission must pursue regulatory initiatives as bold as those it embraced in CC Docket Nos. 78-82 and 80-286.[11] In addition to matters such as full unbundling of network rate elements, universal service reform, and local number portability (concerns that need to be addressed in other proceedings), there are other pro-competitive issues over which the FCC has jurisdiction and which are intrinsic to price cap regulation. These policies include: (1) guarding against price discrimination; (2) preventing against cross-subsidization and predatory pricing; and (3) limiting the degree of pricing flexibility granted to LECs if and until the market completes the transition from monopoly to competition. The Commission, therefore, should modify the goals of price cap regulation to explicitly recognize the goal of fostering competition in the interstate market.

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[11] MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983), modified on recon., 97 FCC 2d 682 (1983), modified on further recon., 97 FCC 2d 834 (1984), aff'd in principal part and remanded in part, National Association of Regulatory Utility Commissioners v. FCC, 737 F.2d 1095 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1995), modified on further recon., 102 FCC 2d 849 (1985).

GENERAL ISSUE 2

The effect of the price cap plan on consumer welfare, the economy, and the creation of jobs both in telecommunications and in other sectors of the economy.

The LEC price cap plan will deliver maximum benefits to the overall economy only if the underlying rules and regulations are properly designed. Specifically, price cap regulation will increase consumer welfare and have a socially optimal effect on employment in every market sector only if it requires LECs move prices toward economic cost.[12] Pricing services at economic cost ensures that consumers pay the amount that it costs to produce the services, while the LECs receive the full cost (including a reasonable return) of providing the services. In this way, the interests of the both parties are balanced: the consumers acquire services at the lowest possible cost while the LECs achieve the highest reasonable profits.

If the price cap rules are not properly designed, one party may benefit at the expense of the other. For example, the Commission's conservative selection of a productivity factor for the first four years of price cap regulation allowed LECs to price access services at artificially high levels, thereby depressing the cumulative beneficial effects potentially lower rates would have had on the economy. The Commission has gained regulatory experience through operation of the LEC price

[12] As the Commission noted in its recent ONA Order, these costs are "the costs a profit maximizing firm would consider in making a business decision to provide a new service." Open Network Architecture Tariffs of Bell Operating Companies, CC Docket No. 92-91, Order, 9 FCC Rcd 440 (1993).

cap system that provides critical information that allows it now to adjust its policies to maximize the economic welfare obtainable through price cap regulation.[13]

Unless the price cap plan is modified to constrain LEC prices to reflect costs more accurately, access prices will continue to be high relative to their economic cost. Because telecommunications is a key input in many economic sectors, incorrect pricing signals will send distorting effects throughout the economy. The Commission should adopt the changes MCI recommends to extend to the entire economy the maximum benefit that accrues from a prosperous telecommunications industry.

BASELINE ISSUE 1: INFRASTRUCTURE DEVELOPMENT

Baseline Issue 1a: Whether, and if so how, the Commission should revise the LEC price cap plan to support the development of a ubiquitous national information infrastructure.

The best way to secure telecommunications infrastructure investment is to establish an environment in which all participants have the opportunity and the incentive to provide a full range of services to all geographic areas. For example, if the Commission adopted specific investment directives for the LECs (other than

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[13] A recent study by Ray Marshall found that immediate Bell Operating Company entry into the long distance market prior to the development of effective local exchange competition would cause employment to be 322,000 lower and real Gross Domestic Product ("GDP") to be $24.4 billion lower by 2003. Conversely, the development of effective local exchange competition would result in 478,000 additional jobs and a $37.0 billion increase in real GDP by that time. Building the Information Superhighway: Getting the Competition Right, Discussion Paper, Ray Marshall, Lyndon B. Johnson School of Public Affairs at the University of Texas-Austin, March 1994.

ones not needed to make the market competitive) as part of its price cap regulation, the government and the LECs would assume the role of defining and creating the national information infrastructure ("NII"), while requiring the IXCs to underwrite it. Alternatively, if the government created a regulatory system that gave LECs additional earnings power in exchange for a promise of infrastructure investment, there is no guarantee that the LECs would spend the money to support an open, unbundled network conducive to competition, or even that they would invest the money in infrastructure at all.[14] LECs would funnel excess profits collected from the rates IXCs pay into construction of a network that by definition would not reflect the interests of a broad sector of telecommunications users and providers. The LECs would design and make network components available in accordance with LEC viewpoints, LEC infrastructure needs, and LEC business and financial goals. These LEC interests could all be served best by stifling emerging competition, thereby depriving consumers of the benefits that ensue from competition. Any government-mandated information highway implementation strategy that keeps the LECs in the driver's seat will only obstruct developing competition.

[14] Many states that have pursued incentive plans are now learning this expensive lesson. Incentive regulation has not guaranteed that LECs will make infrastructure investments. In one study, Tardiff and Taylor found no significant effect of incentive regulation by the states on investment in four infrastructure enhancements: digital switching, fiber, ISDN, and SS7. In addition, they noted no significant positive effect on investment in these areas for those states whose incentive regulation plans included price indexes of sharing mechanisms. See Telephone Company Performance under Alternative Forms of Regulation in the United States, T.J. Tardiff and W.E. Taylor, NERA, September 7, 1993 at Table 4 and Table 5.

Unless the NII is fashioned in response to market demand and not just the LECs' "wish lists," users will be deprived of the broader, more feature rich and diverse network that the Commission's pro-competitive policies and price cap regulation were intended to produce.

Rather than mandating specific LEC network investment or "throwing money" at the LECs in the hope that a modern and open network technology will appear. The Commission can better encourage infrastructure development by implementing policies that enable all willing market participants to maximize their network investments.[15] Instead of fashioning rewards to encourage the LECs alone to implement new technologies in the NII, the Commission should pursue policies that inspire broader-based network investment that is driven by market demand. By adopting policies that (1) require the unbundling of access services; (2) encourage cost-based pricing; and (3) ensure nondiscriminatory access to the LEC networks, the Commission will stimulate construction of a market-driven nation-wide network of networks that delivers more innovative and quality services and options than ever would be developed by the LECs acting alone. In the context of the instant proceeding, the Commission can best assure that LECs

[15] Competition is the key to spurring technology investment. In the highly competitive interexchange arena, MCI has not only announced plans for major network upgrades totalling $20 billion, but it has branded its investment plan with a unique name -- networkMCI -- supported by its own advertising efforts. This marketing campaign provides compelling evidence that infrastructure and technology are essential ingredients for competing in today's telecommunications marketplace.

make wise infrastructure choices by setting the price cap formula to compel LECs to deliver greater productivity achievements.

Baseline Issue 1b: Whether the goal of providing universal service to all geographic areas and of equal type and quality for all Americans at affordable prices is being met, or whether the Commission should revise the LEC price cap plan to ensure the provision of universal service.

Price cap regulation was never intended as a device to address universal service issues, and it did not alter existing universal service goals. In fact, great care was taken in the proceeding to adopt a price cap system that was transparent with respect to universal service subsidies. Therefore, while MCI supports Commission re-evaluation of subsidy policies, it should do so in a separate proceeding that focuses on the myriad of issues involved in the provision of universal service.

The far-reaching changes in the market since the initiation of the current Universal Service Fund ("USF") and Long Term Support ("LTS") programs have raised issues such as which parties should provide universal service and how it should be funded. These matters, however, affect parties other than the price cap LECs and raise questions that are outside the scope of this proceeding. As such, the Commission should address the subsidy question in a notice of inquiry directed specifically at the universal service issue.[18]

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[18] Several parties have urged the Commission to initiate a separate proceeding in which to re-examine comprehensively the universal service issue. See, e.g., Petition of MFS Communications Company, Inc. for a Notice of Inquiry and En Banc Hearings, filed November 1, 1993; Ad Hoc Telecommunications Users

What is relevant in the instant proceeding is that price cap regulation has not had a deleterious influence on universal service. As the Commission observed in the Notice, the percentage of households subscribing to telephone services has increased since the inception of LEC price caps.[17] Because there is no reason to believe that any modifications to the price cap plan resulting from the instant review would be detrimental to existing universal service goals, it would be premature to revise the plan in anticipation of any changes resulting from Commission reconsideration of its overall universal service policies.

BASELINE ISSUE 2: COMPOSITION OF BASKETS AND BANDS

The Commission recently has made significant modifications to the composition of the price cap baskets.[18] Specifically, it deleted the transport service categories from the traffic sensitive basket and created a new "trunking basket" into which it placed both the transport rate elements and special access

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Committee, Petition for Rulemaking, filed April 15, 1994. MCI has filed a white paper as an ex parte in the MFS proceeding: "From a Single Lane to the Superhighway: Rethinking Universal Service Policy for the 21st Century Consumer."

[17] In 1990, the annual average of 93.3% of households subscribed to telephone service; by July, 1993, it increased to 94.2%. (Notice, at para. 29)

[18] The Commission has made minor modifications to access rate elements since initiation of price cap regulation. It has added 800 Data Base and Line Information Data Base elements to the traffic sensitive basket, and has proposed to implement a new operator services element as well. See Treatment of Operator Services Under Price Cap Regulation, CC Docket No. 93-124, Notice of Proposed Rulemaking, 8 FCC Rcd 3655 (1993).

services.[19] In support of this adjustment to the baskets adopted in the original price cap order, the Commission reasoned that "transport elements are more closely related to similar special access services than to local switching and other services remaining in the traffic sensitive basket."[20] It also acknowledged that restructuring the baskets would place into a single basket services that are subject to similar levels of competition:

> [M]oving transport services out of the traffic sensitive basket and into a basket with special access services will prevent the LECs from offsetting rate reductions for transport services subject to competition with rate increases for switching and other traffic sensitive services, which are subject to much less competition at this time.[21]

MCI believes that the current composition of baskets gives the LECs adequate pricing flexibility to respond to any emergence of competition for those services that potential competitors are beginning to offer. As such, this basket configuration serves as a reasonable starting point for the transition to the more flexible pricing rules that may follow the advent of effective competition. The Commission's recent revision of the composition of the price cap baskets appropriately consolidated into a single basket switched and special access transport, thereby achieving notable results. First, by segregating transport

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[19] Transport Rate Structure and Pricing, CC Docket No. 91-213, Second Report and Order, 9 FCC Rcd 615, 622 (1994) ("Trunking Basket Order"). Also, it designated six service categories: in addition to the four existing special access categories, it created a tandem switched transport service and interconnection charge categories.

[20] Id.

[21] Id.

services in a basket separate from switching services, the Commission shielded the non-competitive switching function from price increases LECs would enact to offset responsive price decreases for transport services. Second, services subject to different risks or degrees of competition generally are located in the same basket. That is, the trunking basket contains both switched and special transport services -- the only services for which competition has even begun to develop. It is not clear whether or in what order the switching or local loop functions will face competition. Nor is it relevant because these two discrete services already are located in separate baskets. The emergence of effective competition in one area should have little impact on the pricing rules of the services in the other basket.

Further, MCI submits that the only reason to modify the price cap baskets or bands would be in response to alterations to the underlying access service structure. The current basket composition assumes the existing rate structure. To the extent that competition develops and the carriers require further pricing flexibility, the issue of the appropriate rate structure should be considered